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'Diet' COLA: Advisors talk to clients about the lowest increase in years
By Rob Burgess
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The long-awaited Social Security cost-of-living adjustment (COLA) for 2025 was announced Thursday and it's the smallest in four years.

The 2025 increase of 2.5% was down from the 3.2% bump in 2024. That's less than half of what it was in 2023 when it was 8.7%.

Lowering inflation is the main driver of this subdued increase as the Consumer Price Index (CPI) for Urban Wage Earners and Clerical Workers continues to trend down. The COLA is calculated by comparing the change in the CPI year to year, based on the average of the third-quarter months of July, August and September.

"All of us appreciate getting a pay raise and retirees are no different," said Sri Reddy, senior vice president of Retirement and Income Solutions at Principal Financial Group in Des Moines, Iowa. "And, while not as high as the past three years, a COLA adjustment of 2.5% is reasonable for 2025."

COLA only goes up when inflation goes up, so in the long run retirees shouldn't feel a difference, said Jeremy Keil, a financial advisor at Keil Financial Partners in New Berlin, Wisconsin. It was a problem in 2020 and 2021 because inflation hit but the COLA didn't go up until the following year, he said.

"Thankfully the 2022 COLA of 8.7% came in a year when inflation was lower than that," he said. "Hopefully the 2025 COLA of 2.5% is met with inflation of 2.5% and retirees feel even and not overburdened."

However, Mary Johnson, retired Social Security and Medicare policy analyst previously with the Alexandria, Virginia-based Senior Citizens League, said the millions of Social Security recipients who rely on it "may be forgiven for feeling frustrated."

"With average retiree benefits rising by about $48 per month, that's only going to buy about 14 gallons of gasoline per month at today's prices or maybe enough groceries for one to last two or three days," said Johnson, who at 73, also receives Social Security and Medicare.

Inflation does not burn out of the economy evenly

In theory, these adjustments should align with higher prices for goods, making them a lateral shift, said Daren Blonski, co-founder and managing principal of Sonoma Wealth Advisors in Sonoma, California.

"But does anyone feel like gas and milk are only 2% higher?" he said. "Inflation does not burn out of the economy evenly. To me this feels more like a 'diet' COLA."

Inflation represents one of the biggest and often overlooked risks for retirees on a fixed income, said Shawn M. Perkins, founder and financial planner of Genuine Wealth Solutions in Richmond, Virginia.

"That is why it's incredibly important for retirees and pre-retirees, particularly those that rely heavily on Social Security, to have a strong understanding of their expenses," he said. "Expenses are the only thing in retirement that we have the most control over. My advice to pre-retirees is to plan and save as much as you reasonably can before retirement so that Social Security, and its future, don't dictate the success of your retirement plan. Focus on what you can control, like spending, saving and investing, and we will adjust accordingly if there is a change in Social Security."

While the lowest adjustment in years signals inflation, it still poses challenges for retirees who rely heavily on Social Security as a primary income source, said Jason Gilbert, founder and managing partner of RGA Investment Advisors in Great Neck, New York.

"Retirees may feel squeezed by increasing healthcare costs, housing expenses and other essential needs that often rise faster than the overall inflation rate," he said. "For retirees, the key to coping with smaller COLA increases is a disciplined approach to spending and budgeting. Retirees should prioritize necessary expenses and consider tightening discretionary spending. Furthermore, it's essential to review investments and savings to ensure their portfolios are aligned with their long-term financial needs. For those in retirement, this is a good time to reassess any additional income sources and make strategic adjustments to savings withdrawals or budget plans."

Carla Adams, founder and financial advisor at Ametrine Wealth in Lake Orion, Michigan, said she always reminds clients to prepare for the fact that Social Security may not keep pace with inflation. She has set her financial planning software to assume that the Social Security COLA is .5% less than inflation to assure her clients have enough set aside for retirement.

Building a diversified retirement plan

For pre-retirees, smaller COLAs emphasize the importance of building a diversified retirement plan that doesn't rely solely on Social Security, Gilbert said.

"I often advise clients to anticipate that Social Security will cover only a portion

of their income needs and encourage them to focus on building robust savings in tax-advantaged retirement accounts, like IRAs and 401(k)s," he said. "It's important to incorporate both conservative and growth strategies in their portfolio to hedge against inflation and ensure their assets last throughout retirement."

Few people can live solely off of Social Security benefits, Adams noted.

"I almost always recommend people wait until age 70 before taking Social Security, if they can wait that long, so they can maximize their benefit," she said. "This makes for great longevity insurance. If you live into your 90s or beyond, you're going to be glad you waited to get the higher benefit amount. This by no means implies people can't retire until age 70. Building up retirement savings is key so that people can retire before age 70 and have enough assets to fully cover their living expenses until age 70 so they can maximize their Social Security benefits by not claiming until age 70."

Social Security is a lifeline for 68 million Americans, but inflation has made it harder for retirees to depend on these payments, said Jon McCardle, president of Summit Financial Group of Indiana in Lafayette, Indiana.

"For retirees facing rising costs … budgeting becomes essential," he said. "Many may need to consider part-time work or reassess their spending habits."

Concerns about the long-term viability of Social Security

As for the long-term viability of Social Security, while there are concerns about future funding gaps, Gilbert said he advises pre-retirees not to panic.

"Social Security is unlikely to disappear, but benefit reductions or reforms may come into play in the coming decades," he said. "My guidance is to view Social Security as a foundational element of retirement income, but not the sole one. Diversifying income sources through retirement accounts, investments, and even part-time work in retirement can provide additional security in the event of lower-than-expected Social Security benefits. By preparing today and maintaining flexibility in financial planning, retirees and pre-retirees can better weather smaller COLA increases and other potential changes in the Social Security landscape."

Adams said she believes that Social Security will continue to be around for the long term in some form or another.

"I would guess that anyone in their 50s and older can assume that they will be grandfathered into current Social Security law if and when changes to Social Security benefits come," she said.

John R. Power, a CFP with Power Plans in Walpole, Massachusetts, said he tells clients that Social Security is a fundamental part of the U.S. retirement system that simply is not going away.

"Congress will eventually face up to making adjustments, but because it is painful they will put it off until the last minute," he said. "To not do so essentially would mean volunteering to not be in office. Not going to happen."